

**BEFORE THE
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Notice of Proposed Rulemaking

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This regulatory proceeding has lasted more than five years. The record that has been amassed is beyond voluminous and well into the exhaustive. There can be no reasonable

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criticism that the Department has not heard from enough parties or has not allowed for virtually unlimited input from each – an allowance that some parties have used liberally.

The brave soul willing to read the massive record in this proceeding might be forgiven, however, for finding the views that have been filed sometimes more confusing than enlightening. There have been some stunning inconsistencies in the positions taken by some parties, and the reasons for their abrupt changes of position have not always been explained. It is not simply the positions of a few parties that has changed, however. It is the nature of the argument itself.

In particular, Sabre – by far the largest CRS – has adopted a posture in 2003 (which hopefully will be the concluding year of this proceeding) that is very much at odds with its previous posture. This is not simply a mistake, or a clarification or refinement of its previous views on the issues. It reflects Sabre's understanding that the nature of the argument underlying this proceeding has changed fundamentally. The reader of this record needs to understand that change as well.

Sabre previously had argued that the CRS rules ought not only to be retained, they ought to be expanded – i.e., to the Internet, and through the enlargement of the coverage of the mandatory participation rule. Suddenly, in 2003, Sabre has argued that there should be no CRS rules at all. Sabre previously had argued that CRSs without any airline ownership (which, since the spring of 2000, has included Sabre) should continue to be covered by the CRS rules, and moreover were covered by virtue of marketing agreements with airlines. Suddenly, in 2003, Sabre has argued that any CRS without airline ownership, whether it had a marketing agreement with an airline or not, should not be, and is not, covered by any CRS rules. Most fundamentally, prior to 2003, Sabre took the position that the Department had all of the legal authority that it needed, and had established all of the factual bases that it needed, to continue CRS rules into the

indefinite future. Suddenly, in 2003, Sabre has argued that the Department has no factual basis to support continuation of any CRS rules, and has no authority to regulate any CRS that lacks airline ownership.

Not only has Sabre made this sharp change of tack, but so too have a large number of Sabre affiliates – a trailing line of wholly-owned subsidiaries, Sabre-created organizations, Sabre contractors and subcontractors, Sabre-paid experts, and Sabre-funded groups. They all adopted the new position at the same time, in an impressive, if Orwellian, display of precision drilling.

Why the completely new direction? What has changed?

Sabre's positions may have changed, but its objective has not. If the reader of this record understands this basic principle, he or she can understand what is really at issue in this proceeding.

CRSs long have held, and continue to hold, significant market power, and that power inhibits most of the disciplining effects of competitive market forces. That power is rooted in several key facts:

- The CRS industry is highly concentrated, with only four major CRSs worldwide, only three of which have a significant presence in the United States.
- The CRS industry is characterized by high barriers to entry. The cost and difficulty of entering the CRS business, amassing the necessary computing capacity and specialized programming, and establishing the telecommunications links and commercial relations with thousands of suppliers and users, have been insurmountable for many years.
- Each CRS has under contract a large number of travel agents. These contracts typically are effectively (though not nominally) exclusive and perpetual. They effectively bar most travel agents from using more than one system or from switching systems, by

imposing prohibitively costly penalties on agents who use other systems or try to switch to other systems, and there are virtually no unaffiliated agents left for any new competitor to automate.

There have been two particularly important consequences of these three key facts. First, there has been no competitive entry into the CRS business for over two decades. Second, any airline that relies on travel agents for a significant portion of its sales cannot afford to be expelled from any of these CRSs, because if it were, the airline would be denied access to the agents who use that system, and ultimately to those agents' customers. The contractual hold of each CRS on each of its agents is so tight that no airline could reasonably expect to sell through those agents by alternate means. The immediate revenue loss to the airline would be more than it could sustain. This, in turn, has given the CRSs market power over the airlines. The terms of participation, the levels of service offered, and the amount charged for CRS services, all have been and continue to be dictated by each CRS to each airline. As a result, the cost of air transportation has been artificially raised due to the fact that the cost of automated distribution has been artificially inflated.

The history of CRS distribution is that airlines cannot afford not to participate in each system, and therefore must accept whatever price or other dictates that each CRS has made a condition of participation in its system. This was the core of the CAB's findings when the CRS rules originally were promulgated in 1984, was the core of the Department's findings in 1992 when the CRS rules were renewed, and is the core of the Department's findings today. The Department, for example, has found:

We believe that the systems can engage in such practices [reducing competition or giving biased or inaccurate information about airline services to consumers and agents] because each system still seems to have market power over the airlines. Market forces therefore have not disciplined the price and terms of services

offered airlines by the systems. In particular, the systems appear to be charging booking fees that exceed the fees that would be charged in a competitive industry. (67 Fed. Reg. at 69385.)

Because most airlines have relied on travel agencies to sell most of their tickets, and because travel agencies have typically relied on one system to learn what airline services are available, airlines (with a few exceptions) generally have not been able to afford not to participate in each of the systems. As discussed, an airline's withdrawal from one system would likely substantially reduce its bookings from travel agents using that system. As a result, airlines have not had significant bargaining leverage against the systems, because the systems have not needed to compete for airline participants. (67 Fed. Reg. at 69380.)

The systems have been able to maintain high booking fees, because most airlines have concluded that participation in most systems is necessary. (67 Fed. Reg. at 69370.)

The Department of Justice has made the same assessment of the CRS problem. In its most recent on-the-record comments about market power in the CRS industry, it found:

CRSs have substantial market power over most airlines.... CRSs... are not substitutes from most airlines' perspectives. Each CRS provides access to a large, discrete group of travel agents, and unless a carrier is willing to forego access to those travel agents, it must participate in every CRS. Thus, from an airline's perspective, each CRS constitutes a separate market and each system possesses market power over any carrier that wants travel agents subscribing to that CRS to sell its airline tickets. (DOJ Comments, Docket OST-96-1145, at 2-3 (Sept. 19, 1996).)

That market power is also amply reflected in the recent financial crisis in which every sector of the travel industry, except the CRS sector, has found itself. For the majority of all air transportation sold, the sale is accomplished by a chain of three parties: the supplier (the airline), the automated distributor (the CRS), and the retailer (the travel agent). In 2002, both airlines and travel agents suffered badly, but CRSs continued to amass profits that would be the envy of most companies during good times.¹ U.S. airlines suffered their worst losses in history, and travel

¹ "Unlike many major players in the travel industry, Sabre Holdings turned a solid profit." Sabre 2002 Annual Report, at 3. In fact, Sabre profits rose dramatically despite hard times, defying the gravity that pulled other travel sectors down. "For the year, Sabre holdings earned \$1.50 per diluted share (on a GAAP basis), compared to \$0.24 (continued...)"

agents struggled and went out of business at a heart-wrenching rate. But Sabre scored operating profit margins of over 15% with adjustments for special items, and over 20% without these adjustments. See Sabre 2002 Annual Report, at 13. For the same year, U.S. airline operating profit margins were worse than *negative* 10%.

In an industry characterized by competitive forces, it would be reasonable to expect that during a sharp downturn, the financial pain would be apportioned without enormous disparities across the distribution chain. The fact that there are such extreme differences in this distribution chain is indicative of the fact that one party in that chain holds strong market power and uses it to demand an extraordinary share of revenues flowing through that chain. Relatively comparable levels of bargaining power do not produce a disparity of 25 or 30 percentage points between the profitability of a distributor and the profitability of a supplier in the same distribution chain.

In this proceeding it is the objective of Sabre, and of the large CRSs generally, to preserve their market power and the extraordinary profitability that goes with it, and that has been their objective consistently throughout. The positions they have advocated in pursuit of that objective have, in some instances, proven to be remarkably disposable, but the objective never has changed.

Sabre at first advocated the continuation, and even the expansion, of the CRS rules, because they believed that course of action would best preserve their market power. Since it appeared, late last year, that those arguments were not likely to prevail, they reversed course and argued that there should be no CRS rules at all. They did so in the belief that they still possess market power, that airlines today are more desperate than ever to retain any revenues they still

(continued...)

per diluted share in 2001.” Id. at 4. As other travel sectors sank to record lows, Sabre profits soared to a level six times as great as the previous year.

have, and that airlines can afford less than ever to be expelled from any CRS. Therefore, if the CRSs were not going to succeed in preserving a rule that maintained their market power for them, they wanted maximum license to use that market power to impose contracts on airlines and agents alike that would prevent effective competition from ever being introduced into the CRS business.

What is this competition that Sabre in particular, and the large CRSs in general, are trying to preclude? Every interested party (including Sabre) now knows what it looks like. We have seen it transform the online agency business over the past two years, bringing price competition where none had existed, and making low fares much more widely available than ever before. Before 2001, the major online agencies mimicked CRS pricing, and would not compete for airline participation on the basis of the price that they charged the airlines for distribution services. As a result, the airlines did not sell webfares through the online agencies, just as they did not sell them through CRSs. But to the online agencies, that was not a problem. They preferred the excessive pricing model of the CRS business to greater access to low fares. They were under no competitive pressure to sell webfares, since their major online agency competitors all shared this philosophy and did not choose to obtain webfares either.

All that changed in June, 2001, with the launch of Orbitz. Orbitz offered substantial reductions in the effective price paid by any airline for a booking, if the airline agreed to sell webfares through Orbitz. Over forty airlines agreed to that proposition. Suddenly, online agencies had a competitor that was willing to be a *price* competitor, and that therefore had a wide spectrum of webfares. The other online agencies subsequently did, however reluctantly, respond by becoming price competitors as well, and they did achieve access to most webfares.

The result was that webfares, previously available only on individual airline websites, were are now available also on Orbitz and on the other major online agency websites. Because of this price competition, a basic component of the cost of air transportation – the cost of distribution – for the first time effectively has been disciplined by competition, and has been significantly reduced (although only with respect to tickets sold through online agencies). This is clearly progress in a pro-competitive and pro-consumer direction.

The issue now before the Department is whether to enable that kind of competition to enter the CRS business, and to bring with it the same types of pro-competitive and pro-consumer benefits. If some competitor – either a new entrant or an existing CRS – decided to adopt the strategy of substantial reductions in the price charged to an airline per booking, in return for access to webfares, other CRSs would not be able to avoid responding, just as the online agencies could not long avoid responding to the competitive challenge posed by Orbitz.²

When CRSs do respond, the result will be newfound price competition on the amount an airline is charged for each booking, a significant reduction in the price charged for each booking, and the widespread availability of webfares on CRSs. The advantage to both consumers and to agents would be considerable. They would benefit directly from almost universal availability of the lowest fares. They would benefit indirectly from competitive discipline on a basic cost element of air transportation, making the product more attractive in the competition for the consumer's dollar.

² Orbitz does not consider the recent offering by some CRSs of booking fee discounts to be substantial. They are typically 10%, or are limited to participation by a few agents, as compared to the standard Orbitz reduction of about 30%, and Orbitz's Supplier Link option, which offers a reduction of about 60%. The Orbitz reductions are representative of competitive market pricing of automated bookings. A 10% booking fee reduction – and the accompanying three-year commitment – is a token offer designed to forestall real price competition.

This is exactly the price competition that Sabre in particular, and the large CRSs in general, are trying to prevent. They have lived very profitably without price competition, and they would prefer that life to continue. Their strategy of suddenly pushing for an immediate and complete end of all CRS rules is very much aimed at preventing price competition:

- They would use their market power to contractually require each airline, in order to continue to be sold through a CRS at all, to agree to give all of its webfares to that CRS, without any price reductions. In other words, the airlines would be directed to give up forevermore the only leverage that ever had obtained them any price reduction for automated distribution services. There would no longer be any means by which to bring price competition into the CRS business.
- They would also impose parity clauses as a condition of participation, by which an airline would be required to give a CRS any fare that the airline agreed to give any other CRS, without regard to the price charged for that CRS's services. Parity clauses would remove any reason for any CRS (whether an existing system or a new entrant) to act as a price competitor, since it would obtain no benefits by doing so that its competitors would not also receive without offering any price reductions.
- They would impose on travel agents contracts that would be even more explicitly exclusive and inescapable than those in use today. They would effectively deny agents the leverage of ongoing market choice, which would compel each CRS to compete for the agent's use of their system. The result of agents being effectively denied that choice would be a further strengthening of the market power of the CRS, because the CRS would even more clearly than today be the exclusive path to selling through a large number of agents.

- They would offer – for a price – bias, preference, or to shift market share, because without any CRS rules, there would be no prohibition on their doing so. A CRS would do so not because it was airline-owned (as none of the three largest systems are expected to be), but because doing so would be highly profitable. Neither Travelocity nor Expedia is airline-owned, yet a significant component of their business is selling share-shifts to airlines.³ The difference would be that in the case of online travel agencies there is some limit put on the degree of bias or preference that can be implemented, because consumers easily can switch to other less-biased outlets if the degree of bias becomes so severe as to be objectionable. The user of a CRS, however, is a travel agent under contract to that CRS, who typically cannot switch to another system. When the user is captive, there is no ultimate market limit on the degree of bias that can be forced into the system.⁴

³ Orbitz does not and cannot engage in such practices, because it is precluded from doing so by the contracts it has entered into with its forty-plus Charter Associate airlines.

⁴ Some parties assert that the primary cause for concern in this proceeding is airline ownership, of both CRSs and online agents. In fact, the primary cause of concern is market power, without regard to who holds that market power. The antitrust laws do not single out monopolists of any particular race, tribe, business sector, or industry; they are designed instead to judge and prevent the misuse of market power, in whomever's hands it may reside. For example, some parties have adopted the position that Orbitz should be regulated because it is airline-owned (despite the fact that it sells only a fraction over 2% of all air tickets by value, and the fact that its users are free to switch to any other distribution channel), while Sabre should not be regulated at all (despite the fact that it sells well over 35% of all tickets by value and keeps its users under strict contractual restrictions). Such arguments are clearly as self-serving as they are nonsensical.

Moreover, in a May 30, 2003, letter to the Department's General Counsel, Sabre called the Department's attention to an amicus brief filed by the Solicitor General in a Sherman Act section 2 case that is presently before the Supreme Court, United States v. Law Offices of Curtis V. Trinko, LLP. The letter states that the brief urges the Court to reject the essential facilities and monopoly leveraging doctrines, and asserts that, because these doctrines are the "foundation" of Part 255, the CRS rules must terminate on January 31, 2004. This argument has no merit.

It is not news that the Solicitor General once again has requested the Supreme Court to explicitly state that these doctrines do not create independent causes of action under the Sherman Act. That has been the position of the Department of Justice for more than a decade. Whether or not the Court addresses that issue in the Trinko case – and it does not have to do so to reach a result for either party – the Department's analysis in the NPRM is not affected. Sabre continues to ignore the fact that the jurisdictional basis for Part 255 is section 411, not section 2 of the Sherman Act. Under section 411, the Department "may . . . prohibit some airline conduct permitted by the antitrust laws." 67 Fed. Reg. at 69384. The Department looked at the essential facility and monopoly leveraging doctrines as two of many relevant principles. 67 Fed. Reg. at 69386-88. They are not the "foundation" of Part 255. Indeed, the Department simply has applied the doctrines as "helpful" analytical tools, precisely the use to which the Solicitor General believes they should be limited. Trinko Brief, at 21.

These and similar anti-competitive moves would be within the power of CRSs to implement if all CRS rules were to sunset early in 2004, and they would be more than effective in inhibiting any future possibility of new competition in the CRS business. That is why Sabre has changed its arguments, but in doing so has not changed its objectives.

This proceeding is no longer about whether to deregulate the CRS business. It is about how to do it successfully. Successful deregulation will entail the replacement of economic regulation by effective competition. Unsuccessful deregulation will entail the sheriff leaving town with the CRSs still armed and able to prevent any competition from ever being introduced into the business.

Deregulation is the right answer, but implementing the right answer in the wrong way will result in a disaster, to the great discredit of the idea of deregulation. That is the lesson of California's recent experience with energy deregulation – they had the right goal but took the wrong path to it, and thereby set back the cause of deregulation enormously. Such a mistake should not be repeated here.

The CRS industry can be deregulated with very positive results, if the transition to deregulation is structured such that the CRSs cannot at the outset use their still considerable market power to foreclose any future possibility of new competition. Once there is effective new competition, the CRS market power will be dissipated sufficiently that complete deregulation can be adopted, because the marketplace will thenceforward be disciplined by real competition.

The positions taken by Orbitz in this proceeding are designed to accomplish exactly that result. Moreover, the positions taken by Orbitz would treat all parties the same, without preference to one over another. Any party, whether an existing CRS or a new entrant, which is willing to allow its users to choose, on a transaction by transaction basis, which system to use,

would not present the market power problems of the traditional CRS, and would not be subject to the CRS rules, effective immediately. Any party, whether an existing CRS or a new entrant, that engaged in the CRS business – i.e., that put agents under contract – would be subject to the CRS rules during the transition period.

In sum, in this proceeding the Department can follow a path that leads to no rules and no competition, or it can follow a path that leads to no rules and competition. We believe that the latter course is in the best interest of consumers, travel agents, airlines, and the public generally, and is within not only the Department's authority to achieve, but is its statutory obligation to achieve.

A. The Department has both the authority and the responsibility to regulate all CRSs

Certain parties – most notably Sabre and Galileo, the two largest CRSs, and the two CRSs which lack any airline ownership – have asserted that the Department lacks the authority to regulate CRSs without airline ownership. In particular, Sabre argues that the Department should end all regulation of CRSs, while Galileo argues that the Department should continue to regulate only those CRSs with airline ownership. But as Orbitz explained in its comments, at pp. 43-46, the market power which originally gave rise to concerns about CRSs, and which led to the promulgation of Part 255, was rooted in the fact that each CRS was the exclusive channel to most of the agencies that each CRS had under contract. At the time, every major CRS was owned by one or more airlines, but a CRS without any airline ownership still has that same

market power, and still has the incentive and means to abuse that power, to the profit of whoever its owners may happen to be.⁵ Airline ownership is an incidental factor; market power is not.⁶

The vast majority of industry parties that have filed comments in this proceeding agree that the Department should continue to regulate all CRSs, at least so long as is necessary for a transition to a fully-deregulated environment. See, e.g., Amadeus Comments at 31-36 (Mar. 17, 2003); Alaska Comments at 3 (Mar. 17, 2003); Midwest Comments, at 3-8 (Mar. 17, 2003). Indeed, even the American Antitrust Institute – despite its acknowledgement that it accepts contributions from Sabre, and its close alignment with Sabre on most issues – has concluded that in the absence of “vertical integration” (i.e., airline ownership) CRSs still would have incentives to engage in abusive practices such as display bias: “they may find it in their interest to accept some forms of consideration in return for providing favoritism to an airline.” See, e.g., AAI Comments, at 8 (March 17, 2003). CRS deregulation without transitional measures to ensure competition will not be successful, because the playing field is – and will remain – unlevel.

In addition, Orbitz observes that Sabre’s views as to whether the Department can regulate CRSs based on the nexus of marketing agreements with airlines appears to be determined by whether Sabre believes that the Department’s CRS rules are more likely to benefit or constrain

⁵ In 1984, the CAB concluded that Mars Plus did not have market power not because it was the one CRS that was not airline owned but because Mars Plus had a very small market share, and very few participating airlines. See 49 Fed. Reg. at 11667 (Mar. 27, 1984).

⁶ Certain parties – most notably Sabre, Galileo, and Southwest – further argue that the Department should regulate online travel agencies with airline ownership interests (which presumably would include, in addition to Orbitz, agencies such as Priceline, Hotwire, and OneTravel), but not “independent” agencies. As Orbitz previously has explained, there is no basis for selective regulation of the Internet. See Orbitz Reply Comments, at 4-9 (Oct. 23, 2000). Indeed, Galileo once agreed with this principle, stating that “[h]obbling one group of [Internet] service providers is likely to distort the competitive process and retard innovation.” Galileo Reply Comments, at 22 (Oct. 23, 2000). Moreover, there is a growing understanding that because the online travel marketplace, unlike the CRS industry, is highly competitive (especially since the launch of Orbitz), there is no basis for regulation. “With the growth of the Internet travel industry and the heightened sophistication of the consumer, we believe that the necessity for regulation in this arena has been eliminated.” Alaska Comments, at 7 (Mar. 17, 2003).

Sabre's market power in the foreseeable future. In its most recent comments, Sabre has questioned whether the Department can regulate a CRS solely on the basis of a marketing agreement. See, e.g. Sabre Comments, at 127-128 (Mar. 17, 2003). In 2000, however, Sabre took the position that "Sabre, while no longer airline-owned, is still subject to the Department's CRS rules due to its carrier marketing agreements." Sabre Comments, at 2 (Oct. 27, 2000). Moreover, as the Department knows, upon the full and final divestiture of American's equity interest in Sabre, Sabre argued to the Department that it should and did remain subject to Part 255 by virtue of its marketing agreements with American and Southwest. Only recently has Sabre reversed its position on this issue. Presumably, Sabre has realized (following the issuance of the NPRM) that the Department is unlikely to retain the mandatory participation rule, which has had the perverse effect of entrenching CRS market power – and has changed its position not out of any new insights into the Department's authority but because Sabre would no longer be advantaged by regulation.⁷

Finally, the Department should consider making Part 255 directly applicable to CRSs as ticket agents, as proposed, *and* prohibiting travel agencies and airlines from doing business with a CRS that does not comply with Part 255. This would ensure that, even if any questions arise as to the Department's authority to regulate CRSs directly, the Department would be able to prevent CRSs from abusing their market power. Such a regulation would be rooted in the fact that it is the participation of both airlines and agencies in CRSs – even though the airlines and agencies

⁷ Moreover, certain statements by Sabre about its past practices are of questionable accuracy. At the May 22, 2003 hearing, Sabre stated that it "never" has offered, sold, or arranged air transportation directly to consumers. See Hearing Transcript, at 10. In fact, from 1985 until 1999, Sabre offered "easySabre" – a simplified CRS interface – directly to consumers, initially through public-access computer networks and later over the Internet. See, e.g., "Sabre to phase out easySabre," Travel Weekly (June 3, 1999); Sabre Comments, at 21 n.9 (Dec. 9, 1997) (easySabre is "marketed to individual users through public data networks").

may lack any ill intent or market power of their own – that has provided the essential ingredients for the CRSs’ market power. For example:

- The Department has found that airline participation in CRSs can contribute to the problem of dominant hubs. See 67 Fed. Reg. at 69388.
- The Department has found that an agency’s use of CRSs with productivity pricing features can cause consumer harm. See 67 Fed. Reg. at 69408-09.
- The Department has proposed to revise the rule on marketing and booking data to directly prohibit the airlines from buying or otherwise obtaining certain data, “since our authority to bar systems from selling the data is unclear.” See 67 Fed. Reg. at 69404.
- The Department has found that an agency’s use of a CRS that did not abide by the proposed revised rule on marketing and booking data also would exacerbate hub dominance problems. See 67 Fed. Reg. at 69404.

Of course, it is extremely unlikely that the Department, if it adopted this approach, would ever find itself bringing an enforcement action against and imposing a penalty on an airline or agency for anti-competitive conduct by a CRS, for which the airline or agency was not at fault. But the power to command an airline or agency not to participate in a CRS unless that CRS corrected violations of Part 255 would be a effective enforcement tool for the Department in compelling compliance by a CRS, and would ensure that the Department will be able to fulfill its responsibility to prevent anti-competitive behavior by CRSs. At the May 22, 2003 hearing, both American and Worldspan noted that this approach was an option, see Hearing Transcript at 44-45, 93, and it is noteworthy that this approach was once also proposed by Sabre. See Sabre Comments, at 14 (Sept. 22, 2000).

B. The CRS rules' prohibition on display bias should be retained

Certain parties have asserted that the Department should repeal Part 255.4, which prohibits display bias. It is noteworthy that the staunchest advocate of this course of action is the largest CRS, Sabre (and, to a lesser extent, Galileo), which, as noted in the previous section, would have the most to gain from the repeal of the rule. It should be clear that the immediate and complete elimination of the display bias rule would harm the majority of consumers who continue to rely on travel agencies that are dependent on CRSs, and would harm travel agencies as well, by making it more difficult to provide objective information to their customers.⁸

No matter what their ownership, the market power of these CRSs provides them both the means and the motive to sell bias to the highest bidder. Bias is a valuable commodity. At the May 22, 2003 hearing, ITSA (the members of which include Sabre and Galileo) stated that it did not consider the sale of "shelf space" to airlines to be a form of bias. See Hearing Transcript, at 255.⁹ But "[a] superior display position might provide profits to an airline," see Mercatus Center Comments, at 10 (Mar. 17, 2003), and a CRS likewise would profit from the sale of such shelf space. This is a cost which the U.S. airline industry is in no position to bear, apart from the obviously detrimental effects for the consumer of a bidding war for preferential displays which would make the best flight options more difficult for travel agents to find. See, e.g., Northwest

⁸ In addition, Sabre appears to have admitted that it is today violating Part 256.4, which was adopted in 1984 as an adjunct to the overall prohibitions on display bias then under review by the CAB. See Sabre Comments at 140 (Mar. 17, 2003). Sabre asserts that it will not show any code-share flight more than two times, but Part 256.4 specifically prohibits CRSs from denying access to or biasing the display of code-share flights. See also Order 94-5-35 (Sabre prohibited from discriminating against display of Lan Chile/Carnival flights); Order 89-1-31 (CRSs may not "expunge" suspect listings unless and until the Department has determined that they are "misrepresentative").

⁹ ITSA is also among the parties that have not complied with the Department's requirement that written statements provided at the May 22, 2003 hearing also be filed in the docket. See 68 Fed. Reg. at 27948 (May 22, 2003).

Comments at 12 (Mar. 17, 2003); US Airways Comments, at 3-4 (Mar. 17, 2003); ASTA Comments at 34-35 (Mar. 17, 2003).

Although the Internet plays an increasingly significant role in the distribution of air transportation, most travel agencies continue to rely on a single CRS for information; according to the most recent ASTA Agency Automation Study (2002), 93.6% of agencies use only one CRS. See id. at 34.¹⁰ Because consumers using the Internet can switch to another vendor with a click of a mouse, bias is constrained by market forces. The Internet is not comparable to the CRS marketplace, because no vendor can exercise market power. But the re-introduction of bias into CRS displays, where agencies cannot easily turn to another source of information, would raise serious consumer protection concerns, and would be a heightened abuse of market power. Indeed, CRSs have structured their contracts with travel agencies to make it as difficult as possible for them to book through any other means. Absent any rules, CRSs would be free to effectively bar agents from having any competitive choices. The Department should adopt rules that would promote travel agency access to alternative channels of distribution, as Orbitz explained in its comments, at pp. 46-57. Moreover, the Department should encourage distributors and agencies to voluntarily commit themselves to providing unbiased displays to consumers, as has Orbitz through its contracts with its Charter Associates.¹¹ But as a practical matter, agencies do not yet have unfettered access to alternatives, and any discussion of the repeal of the anti-bias rule is premature.

¹⁰ As explained in Orbitz's comments, at pp. 47-48, even though travel agencies have a very high level of access to the Internet, they primarily use the Internet to gather information, and not to make bookings for air transportation.

¹¹ NBTA suggests that Orbitz is biased because it gives preferential treatment to particular carriers, and namely that Orbitz fails to make available the corporate fares of participating airlines. See NBTA Comments, at 17 (March 14, 2003). NBTA's claims are without merit. NBTA has not provided any coherent explanation of how Orbitz gives preferential treatment to particular carriers (in fact, Orbitz is barred by contract from biasing its displays to the advantage of any airline or airlines), nor has NBTA explained how the fact that virtually every online travel agent, including Orbitz, does not display fares that are not available to the general public amounts to a form of bias.

C. Booking-by-booking transactions should be excluded from the definition of “system”

Certain parties have asserted that the Department should not modify the definition of “system” by requiring that it be “used by a subscriber under a formal contract with a system,” as the Department has proposed. See, e.g., Amadeus Comments at 42-43 (Mar. 17, 2003), Sabre Comments at 129 (Mar. 17, 2003), Southwest Comments at 9 (Mar. 17, 2003). As Orbitz explained in its comments, at pp. 42-43, the Department should adopt this proposal, but in a form that makes clear that it is intended to exclude vendors to the extent that they are used by agencies on a transaction-by-transaction basis without any ongoing contractual commitments. Such a vendor would not have the potential for the anti-competitive conduct that Part 255 is designed to limit, because such a vendor would not be the exclusive channel by which an airline could reach any travel agency, unlike the existing CRSs. The Internet has demonstrated that information and automation services can be provided to users without putting those users under long-term contracts that bind them exclusively to one channel. It has also demonstrated that when users can readily switch to other channels, choice triggers the vigorous competition that characterizes the Internet.

The parties opposed to this proposal appear to have misunderstood the Department’s intent. This proposal is not intended to create a regulatory loophole for Orbitz, if Orbitz were in the future to enter the business of distributing air transportation directly to travel agencies. Instead, it is intended to acknowledge that any vendor – including an existing CRS – that deals with agencies on a transaction-by-transaction basis has solved the problem that necessitated the CRS rules, and should be able to operate without them. It is a free-market provision, and is available to all. If Sabre were to offer its services to agencies on a transaction-by-transaction basis, it would not be subject to regulation as a Part 255 “system.” If Sabre truly wants to compete,

free of Part 255 regulation, all it would have to do is allow agencies free choice among its CRS and other channels for making bookings. Presumably, Sabre opposes this proposal because its market power is derived from the long-term contracts it currently enters into with travel agencies, which deny agencies such free choice.

This proposal by the Department effectively offers the full and immediate sunset of the CRS rules to any CRS that is willing to address the problem that originally necessitated the CRS rules – that a CRS obtained market power by making itself the exclusive path to a significant number of travel agencies. This proposal in effect offers to the CRSs: “You can immediately be governed by the competitive marketplace rather than by regulation – if you will allow a competitive marketplace to exist by allowing travel agents ongoing market choice as to the means by which they make their next booking.” Any CRS that truly wants to operate in a competitive marketplace will support this proposal.

D. Airlines should not be required to offer webfares through all distribution channels

Certain parties – most notably the Large Agency Coalition and the National Business Travel Association – have argued that airlines should be required to offer their webfares through all distribution channels.¹² Although Orbitz briefly referred to this issue in its most recent

¹² The Large Agency Coalition describes its proposal as a “universal participation” rule, which would not just require airlines to distribute webfares more widely but would require *all* airlines to make *all* fares available through *all* channels of distribution. See LAC Comments, at 38-39 (Mar. 17, 2003). One result of this proposal would be that airlines would be required to purchase the distribution services of CRSs, without regard to the cost of those services. The current mandatory participation rule (Part 255.7) at least purports to address the cost of distribution issue (even though the requirement is ineffective in practice) by requiring that fees be reasonable, with reference to the fees that an airline’s own CRS charges. See Orbitz Comments at 32-35 (Mar. 17, 2003). But if a “universal participation” rule were adopted, this requirement would be simply inapplicable to most airlines. In order to ensure that CRSs did not abuse their government-granted franchise over airlines, the Department would have no option but to regulate the fees charged by each CRS. Nothing less than full-blown utility-style price regulation would make this proposal workable. See generally Orbitz Reply Comments, at 26-27 (Oct. 23, 2000).

comments, at p. 35, n.17, it bears repeating that this proposal, if adopted, would be the end of any price competition, or hope for price competition, in the automated distribution business. All airlines would be required to use all distribution systems, without regard to what price those distribution services charged for their services. The effect on the costs of distribution would be harmful in the extreme, and would be without any public interest justification. See America West Comments, at 31-34 (Mar. 17, 2003); Continental Comments, at 10 (Mar. 17, 2003); Northwest Comments, at 20 (Mar. 17, 2003). As the Department has recognized, not only do “the pro-competitive policy directives in 49 U.S.C. § 40101 allow airlines to choose the channels for distributing their services as well as the prices and terms of sale for different channels,” but “[s]uch a requirement might also deter airlines from offering the lower fares at all.” Order 2000-10-13, at 4- 5. See also Orbitz Reply Comments, at 18-23 (Oct. 23, 2000).

In contrast, if the CRS business can undergo the same competitive transformation that the online travel business has undergone since Orbitz launched in 2001, then CRSs would compete for access to webfares, and would gain access to them by making the fees that they charge to airlines for the use of their systems more attractive. The result would be that in CRSs, as in online travel today, nearly all fares would be available through nearly all outlets – but that result would have been achieved by a method that lowered distribution costs. But if CRSs are granted an entitlement to webfares, regardless of the fees that they charge, distribution costs will only continue to spiral upwards. Because the travelling public ultimately pays those distribution costs, there is no question which method best serves the public interest. Moreover, although the steps so far taken by CRSs to gain access to webfares could be described as half-hearted, see Orbitz Comments at 24 & n.13 (Mar. 17, 2003), they do show that the potential for transformation is real. As Sabre itself has stated, “CRSs should be permitted and encouraged to

compete with each other to have access to distribute these fares.” Sabre Reply Comments, at 10 (Feb. 3, 1998).

E. CRSs should not be allowed to require airline webfares as a condition of participation

Certain parties – most notably Sabre and Galileo – argue that the Department should not adopt its proposed prohibition on CRSs making the provision of webfares a condition of participation in those CRSs (in the proposed Part 255.6(e)). This proposal is related to – but distinct from – the Department’s proposal to prohibit CRSs from requiring airlines not to “discriminate” against travel agencies that use that CRS (also in the proposed Part 255.6(e)), both of which were briefly referred to in Orbitz’s comments at p. 37, which explained why the Department should expand the application of the also-intertwined requirements of the existing anti-parity rule (Part 255.6(e) in the existing rules, Part 255.6(d) in the proposed rules).

Orbitz understands that the condition-of-participation proposal would prohibit a CRS from requiring an airline’s webfares, or any other fares that the airline had chosen not to sell through CRSs or travel agencies, as a precondition to participation in that CRS. It would not, however, prohibit negotiations between a CRS and a participating airline by which the CRS would discount its costs and/or provide additional services in return for obtaining access to webfares. See generally American Comments at 25-28 (Mar. 17, 2003); Delta Comments, at 37-39 (Mar. 17, 2003); Midwest Comments, at 7 (Mar. 17, 2003).

In other words, this proposal would bar CRSs from leveraging their existing market power to prevent any possibility of price competition for their services. But CRSs would be able to *offer* airlines lower prices for their distribution in return for wider access to fares, just as online travel agencies do today, and airlines likewise would be able to *voluntarily* accept these

offers. Orbitz, for example, does not require that any airline provide it access to webfares in order for that airline to receive unbiased display in Orbitz. But Orbitz has a standing offer to all airlines: in return for webfares, it will provide additional benefits in return, including an offset of the excessive costs of making a booking through a CRS. For forty-two airlines, this has proven to be a highly attractive proposal. Similarly, Expedia and Travelocity have in the past year entered into agreements with airlines by which they have lowered the cost to an airline of making a booking in return for access to that airline's webfares. See Orbitz Comments, at 16-18 (Mar. 17, 2003).

Recent CRS bids for webfares have found a relatively subdued response, because most airlines have judged the strings-attached CRS concessions not to match the value of their webfares. See supra footnote 2. But if CRSs could use their market power to command access to webfares – by making them a precondition to participation, and thus without having to offer commensurate concessions in return for those fares – then all hope of price competition in the CRS market would be lost. A CRS could endure without the participation of an airline far longer than any airline could endure without participating in a CRS. See Orbitz Comments, at 13 (Mar. 17, 2003).¹³ For example, in 1984, Continental refused to pay a booking fee increase of more than 600% by PARS. But after its bookings from PARS agents plunged by more than 50%, Continental bowed to the dictated terms. See 56 Fed. Reg. at 12594 (Mar. 26, 1991). More recently, AirTran attempted a business model that shunned the CRS distribution channel, but

¹³ As Ron Cole, America West's Vice President of Sales, stated at the May 22, 2003 hearing:

The Computer Reservation Systems have had and continue to have market power over most airlines. In the case of America West, they have monopoly power. Why? Because the CRS vendors know that for the foreseeable future, we have no choice but to continue to offer our product through their systems. Dropping out of even the smallest CRS could mean the loss of \$50 million in revenue to America West. This is an unacceptable penalty that we would have to pay.

Hearing Transcript, at 80-81 (May 22, 2003).

eventually resigned itself to participating in Sabre and other CRSs. Cf. Galileo Comments, at 27 n.31 (Dec. 11, 1997). The proposed rule would strike a balance, under which negotiation for webfares would be possible but CRSs could not abuse their market power to obtain webfares without any need for negotiation, by the threat of denying airlines access to a distribution channel that continues to be essential.

F. There is no basis to require airlines to divest their ownership interests in Orbitz

Certain parties – most notably Sabre and Travelers First¹⁴ – have asserted that airlines should be required to divest their interests in Orbitz.¹⁵ In the case of Orbitz, neither the Department, nor the Inspector General, nor the Department of Justice, despite years of review of Orbitz, have found any reason to regulate, litigate, or direct any different behavior by Orbitz. Given these basic facts, there certainly is no basis to order its divestiture – a measure neither the Department, nor the Department of Justice, nor the Civil Aeronautics Board ever was willing to take with respect to CRSs, even though all of them did find CRSs to possess market power. In contrast, no agency has found Orbitz to possess market power – and it is highly unlikely that any agency would, given that only approximately 2% of all airline tickets by value are sold through Orbitz, and users are free to switch to any other channel of distribution at any time, with the click

¹⁴ Travelers First purports to be a coalition of public interest organizations. But Orbitz notes that its chair, Jim Conran, also is the president of the organization Consumers First. According to the public records of the California Secretary of State, Consumers First accepted more than \$20,000 from a committee of insurance companies in return for its opposition to a 2000 California ballot proposition that would have eased restrictions on consumer lawsuits against insurance companies. Travelers First has not disclosed whether it or any members of its coalition have received payments from an interested party in return for the positions they have taken in this proceeding.

¹⁵ Sabre includes as an appendix a study by Steve C. Salop and John Woodbury that calls for the divestment of airline ownership interests in CRSs – and Sabre itself argues that Orbitz already should be regulated as a CRS. See, e.g., Sabre Comments, at 12, 83 (Mar. 17, 2003). Orbitz responds to the latter allegation in greater detail *infra* in section G.

of a mouse. See, e.g., Orbitz Comments at 20, 23 (Mar. 17, 2003).¹⁶ In sum, this line of argument amounts to little more than grandstanding which has no place in this proceeding.

G. Navigant International's "Aqua" software does not trigger Part 255 coverage of Orbitz

Certain parties – most notably Sabre, Galileo, and Southwest – have argued that Orbitz already is subject to Part 255, utilizing two general lines of argument. The first is a generalized claim that it “replicat[es] the functionality of traditional CRSs.” This vague assertion clearly fails to establish that Orbitz is subject to the CRS rules. Part 255 is predicated on a system being offered to subscribers, among other specific requirements. Although nothing prevents a travel agency from accessing and booking a ticket through its website, Orbitz does not promote or encourage such use of its website, nor does it have any features specifically designed for travel agent use. By this standard, any and every travel website with an airline affiliation would be subject to the CRS rules. The open nature of the Internet means that any website – including Sabre’s Travelocity, Galileo’s CheapTickets, and Southwest’s site – will at least occasionally be used by a travel agency, and thus “replicate” the functionality of a CRS. The result of this line of argument would be the full regulation of many online travel agents and airline websites by Part 255, a purpose for which the rules never were intended and for which there is no justification.

The second line of argument is based on Orbitz’s relationship with “Aqua,” a software product of Navigant International, which enables travel agencies to simultaneously view fares

¹⁶ At the May 22, 2003 hearing, Southwest and Expedia asserted that Orbitz had market power, based on its share of online sales. See Hearing Transcript, at 167, 223. But by this measure, Expedia and Travelocity also should be found to have market power. Even taking into account the widely-quoted conclusion by Jupiter Research that approximately 30% of leisure and unmanaged business tickets soon will be sold over the Internet, online agents account for less than half of the sales made over the Internet, and Orbitz, Expedia, and Travelocity compete fiercely not only with each other and airline sites, but with other online agents such as Galileo’s CheapTickets and Amadeus’ OneTravel, as well as with opaque sites such as Priceline and Hotwire.

available through a CRS and selected fares obtained by Aqua from Orbitz.¹⁷ This argument both misrepresents Aqua's functionality and misunderstands the CRS rules.¹⁸ Aqua is not currently a means by which travel agencies can make a booking on Orbitz. Aqua provides data about fares available through Orbitz for comparison purposes only; it does not have the capacity to make bookings or issue tickets. Aqua is no more a CRS than is ATPCO, the OAG website, or screen-scrapers such as SideStep which offer information about fares elsewhere available, but lack any booking or ticketing functionality of their own. "The rules do not cover computer systems that provide some but not all of these CRS functions." 57 Fed. Reg. at 43793 (Sept. 22, 1992). Moreover, Orbitz simply supplies data to Aqua; Orbitz does not have any direct relationship with the agencies that use the Aqua software, and Navigant International, which provides and supports the "Aqua" software, is not an airline. Thus, the offeror of Aqua lacks the airline

¹⁷ Some of these misconceptions appear to stem from articles that recently have appeared in Travel Weekly, which inaccurately suggested that Aqua has booking functionality. See Hearing Transcript, at 59 (May 22, 2003). Travel Weekly subsequently published a correction.

¹⁸ Aqua aside, other serious misrepresentations have been made about Orbitz, and about the distribution of air transportation in general, in comments filed with the Department.

- For example, Galileo has asserted that all airlines that participate in Orbitz are subject to its "MFN" provisions (which are discussed in greater detail *infra* in section I). See Galileo Comments, at 48 (Mar. 17, 2003). In fact, hundreds of airlines participate in Orbitz that are not Charter Associates (which have agreed to the "MFN" provisions in return for other significant benefits from Orbitz), including significant low-fare airlines such as AirTran. In addition, Galileo has asserted that its booking fees are reasonable relative to the service fees imposed by Ticketmaster and ATMs. As Orbitz previously has noted, this is not only an apples-to-oranges comparison, but ignores widespread criticism of the levels of Ticketmaster and ATM fees. See Orbitz Reply Comments, at 34 (Oct. 23, 2000).
- Similarly, Sabre has asserted that Orbitz imposes a surcharge on airlines that are not Charter Associates. See Statement of Steven C. Salop, at 9 n.6 (May 22, 2003). In fact, Orbitz charges the same service fee for Charter Associates and most non-Charter Associates, including significant low-fare airlines such as AirTran. In a few cases, an airline has informed Orbitz that it pays commissions only if an agent agrees to "move market share" for that airline. Because Orbitz is contractually-prohibited from biasing its displays, it cannot agree to such terms, unlike Expedia or Travelocity. Therefore, like many other travel agents, Orbitz has raised its service fees to offset the lost commissions. In addition, Sabre has asserted that the only major airlines that do not participate in the limited discounts offered through its Three-Year DCA and Galileo's Momentum programs are owners of Worldspan and/or Orbitz. See id. at 8, n.5. In fact, the majority of "major" airlines, as defined by the Department, have chosen not to participate in these limited programs, including Alaska, America West, ATA, and Southwest, none of which are owners of Worldspan or Orbitz.

affiliation (ownership, marketing, etc.) which is an additional prerequisite for regulation under Part 255.

In contrast, if Orbitz were to design and offer a version of its website directly to travel agencies specifically for travel agency use, that website would be subject to regulation under the existing terms of Part 255. If a website: directly and specifically offers travel agencies an automated service that displays multi-airline schedules, fares, rules, and availability; makes bookings; issues tickets; charges airlines a fee for its system services; and is owned, controlled, operated or marketed by an airline; then it constitutes a covered CRS. But that description does not depict any service that is today offered by Orbitz. If the Department wishes to regulate entities that merely share similarities with its existing definition of a CRS, but do meet the full requirements of its definition, the Department must do so by rulemaking. As several wise men once said, “close only counts in horseshoes and hand grenades.”

H. The cost to an airline of a booking through Orbitz is less than a booking through a CRS

Certain parties – most notably Sabre and the Large Agency Coalition – have argued that the cost to an airline of making a booking through Orbitz is more than making the same booking through a CRS. This assertion, which has been made repeatedly by CRSs especially, is typically based on serious misrepresentations of the costs to airlines of making a booking. For example, although many airlines no longer pay base commissions to travel agencies as a matter of course, airlines continue to pay incentive commissions to many travel agencies. The amount of these commissions – which average 3% of total passenger revenues – is a significant issue for airlines, as demonstrated by recent disputes between both Travelocity and Expedia and Northwest, among other airlines. See Orbitz Comments, at 17-18 (Mar. 17, 2003). Thus, the cost of commissions

paid to agencies using a CRS, relative to the cost of a booking made through Orbitz, is a relevant and significant factor in determining which channel is less costly to an airline. The allegations made by Sabre and other parties invariably count the fee that an airline pays to Orbitz as a commission, but do not count the commissions that airlines continue to pay to travel agents that use CRSs. The result is a highly skewed apple-to-oranges comparison.¹⁹

Orbitz has attached a recent study it commissioned, by Global Aviation Associates, that reviews the costs of making a booking through Orbitz – including through its “Supplier Link” with an increasing number of airlines²⁰ – in greater detail, as well as reviews additional fallacies that have been introduced into cost comparisons proffered by Sabre and other parties. See Exhibit A. This study demonstrates that the average cost to an airline of a booking made through Orbitz today is consistently less than the average cost of a booking made through a CRS. The weighted average cost to an airline of a booking made through Orbitz is \$16.43 for all airlines, \$16.22 for Charter Associates, and \$9.58 for airlines with a Supplier Link.²¹ In contrast, the average cost of a booking made through Sabre is \$26.20 – a difference of up to 63.4%. See id. at 6. Furthermore, CRSs historically have increased their fees each year, regardless of their actual costs or the health of the air travel industry. In contrast, the cost to an airline of a booking made through Orbitz has declined each year.

¹⁹ The Large Agency Coalition appears to be under the misconception that the “rebate” that Orbitz offers to Charter Associates for bookings processed through Worldspan *increases* the cost of a booking made through Orbitz. See LAC Comments, at 26 (Mar. 17, 2003). In fact, it significantly *decreases* the cost to an airline of such a booking.

²⁰ In 2002, Orbitz established direct connections with American, Continental, and Northwest. In 2003, Orbitz expects to establish direct connections with America West, Midwest Airlines, and US Airways – all of which are Charter Associates of Orbitz, but do not have any equity ownership in Orbitz.

²¹ Because the substantial majority of Orbitz’s sales are for travel on one of its forty-plus Charter Associates, the weighted average cost for Charter Associates differs only slightly from the weighted average cost for all airlines.

I. Orbitz's so-called "MFN" provisions are both pro-consumer and pro-competitive

Certain parties – most notably Sabre, Galileo, and Expedia – have argued that the Department should prohibit the provisions of Orbitz's Charter Associate agreements which commonly have been referred to as "most favored nations" or "MFN" provisions. Orbitz previously has responded to similar allegations, and explained why its "MFN" provisions are pro-consumer and pro-competitive – and how thirty-seven airlines, in addition to the equity investors in Orbitz, have concluded that the effective reduction in booking fees that they receive in return is a fair bargain. In particular, Orbitz explained how it has increased the information available to consumers. The "MFN" provisions are *non-exclusive* and permit participating carriers to offer the same fares through any other distribution channel. In contrast, the burdensome requirements previously imposed on airlines by Sabre and other CRSs (which also were referred to as "MFN" provisions, but were very different in substance) required airlines to purchase CRS services that the airlines did not want, and provided no consumer benefits. See Orbitz Reply Comments, at 23-26 (Oct. 23, 2000). Moreover, Sabre continues to try to impose similar requirements on airlines that are not protected by Part 255.6(e) in the guise of "parity" clauses. See Orbitz Comments, at 36 (Mar. 17, 2003). Those comments need not be repeated further here.

The one new argument about "MFN" provisions that has been submitted to the Department is a short paper authored by Jerry Hausman, which is an appendix to the comments of Galileo.²² Despite Galileo's description of Mr. Hausman as "independent," see Galileo

²² At the May 22, 2003 hearing, Galileo asserted that its online agent Trip.com had been consolidated with its other online agent, CheapTickets, in April 2003 because Trip.com had been unable to obtain access to the same fares offered by airlines through Orbitz. See Hearing Transcript, at 64-65. However, at the time, Cendant's CEO asserted that the consolidation was due to the challenges of "operating two brands" and the "current geopolitical (continued...)"

Comments, at 2 (Mar. 17, 2003), his previous submission in this docket was funded by the Interactive Travel Services Association, whose membership consists of Galileo, Sabre and other entrenched distributors. In his latest study, Mr. Hausman restates his claim that the Orbitz “MFN” provisions would work against the interests of consumers by reducing fare dispersion – i.e., the degree of variance among fares in a given market. His theory can be summarized as the dubious proposition that greater price transparency is bad for competition and bad for consumers.

Mr. Hausman’s latest study selects a group of city-pairs, and compares the fare dispersion in Q2 2001 with Q2 2002. Based on that comparison, he concludes that fare dispersion has declined – by 2.4% according to one methodology, and by 4.7% according to another. He then isolates those city-pairs in which Southwest does not compete, and finds that fare dispersion also decreased in those markets, by a minutely greater amount. Put another way, the change in fare dispersion for all of the city-pairs selected by Mr. Hausman produced a coefficient of variation of -0.02442, and change for all non-Southwest city-pairs he selected produced a coefficient of -0.02732, among other calculations. He attempts to argue that represents a significant difference.

Finally, Mr. Hausman compares the fare dispersion over the same time period for the city-pairs in which Southwest does compete. Unlike for the earlier two comparisons, he declines to actually disclose the results of this comparison, but characterizes the results generally: “I do not find any of the fare changes to be negative and statistically significant,” as he did for the first two comparisons. See id. at 10. Indeed, he acknowledges (albeit in a footnote) that the trend he has noted in the Southwest fare dispersion is not statistically significant. See id. at 11, n.16.

(continued...)

environment.” See David Kesmock, “Cendant cancels Trip.com to focus on Cheap Tickets,” Rocky Mountain News, at 6B (April 3, 2003).

Out of this thin statistical gruel, Mr. Hausman attempts to conclude that his original theory about the Orbitz “MFN” provisions has been borne out. As a general matter, it can be said that rarely have so few numbers been so tortured to so little result. The gaps in both facts and reasoning vastly exceed the amount of remaining cloth. To note only a few of the gaps:

- The degree of price dispersion in a market can vary based on many factors. Some of the factors which tend to reduce price dispersion are anti-competitive (e.g., effective price collusion) and some are highly pro-competitive (e.g., more perfect price transparency in a commodity market). There is no basis for concluding that any decline in price dispersion in air fares indicates any anti-competitive effect or any anti-consumer harm.²³
- Mr. Hausman has failed to establish any harm to consumers. He acknowledges that in the time period and markets he studied, average fares actually declined. See id. at 11. Most consumers would consider that to be a positive development. Indeed, in recent months it has been far more common for analysts to criticize Orbitz on the basis that the greater price transparency it has brought to consumers has driven down fares, and thereby hurt the economics of major airlines, even while benefiting consumers. Mr. Hausman concludes precisely the opposite – that greater price transparency has made fares higher than they otherwise would be. But he presents no evidence that that is so.
- Only two quarters of fare data have been selected for comparison. Other quarters may produce different results. We cannot tell whether he has made other comparisons or not,

²³ Moreover, because Orbitz offers neither secrecy nor two-way communication, it would be useless as a means of collusion. Orbitz has no mechanism that allows direct and private communication among airlines or from Orbitz to airlines about fares. Further, the only fare offers that Charter Associates are obligated to give Orbitz an opportunity to match are fares that already are public information – i.e., fares offered through an airline website or another online agency. See Orbitz Reply Comments, at 31 (Oct. 23, 2000). In contrast, Travelocity is an advocate of “secret” deals among airlines and agents. See Hearing Transcript, at 200 (May 22, 2003).

and we cannot tell whether Q2 2001 is representative of the pre-Orbitz marketplace, or whether Q2 2002 is representative of the post-Orbitz marketplace.

- Mr. Hausman has made no effort to control for many factors that should be obvious to an analyst. He states that Southwest is the only major airline that is not an Orbitz Charter Associate. In fact, ATA – as well as other low-fare carriers that have significant market effects, such as JetBlue, AirTran and Frontier – are not Charter Associates, but he has made no effort to isolate their effects on his calculations. Likewise, Mr. Hausman utterly fails to address the effects on his calculations of the September 11, 2001 terrorist attacks, which occurred between his selected quarters, and which had unprecedented effects on the marketplace.
- It is especially odd that Mr. Hausman presents his statistical results for his comparison of all of his selected city-pairs in the aggregate, as well as for the subset of city-pairs in which Southwest is not a competitor, but not for the subset of city-pairs in which Southwest is a competitor.
- Mr. Hausman has not attempted to evaluate the pro-competitive effects of Orbitz's so-called "MFN" provisions. Specifically, they have brought about price competition in the online distribution business for the first time. They have resulted in webfares becoming more widely available to consumers – not only through Orbitz, but through online competitors who, in response to Orbitz's MFN, have offered lower distribution costs to airlines in order to obtain access to webfares. The benefits of lower costs of air travel and wider availability of low fares are significant for consumers, and have come about directly as a result of Orbitz's airline-cost-discounts-for-webfares competitive strategy – i.e., the so-called "MFN" provisions.

In short, Mr. Hausman has not established that fare dispersion generally has declined since the launch of Orbitz; has not established that if fare dispersion has declined, that Orbitz's "MFN" provisions are the cause; has not established that if fare dispersion has declined, it is indicative of a negative effect on competition or of harm to consumers; and has not established that if any harm has been caused by Orbitz's "MFN" provisions, it is not more than offset by other pro-competitive and pro-consumer effects of Orbitz's entry into the marketplace as a price competitor. As Amadeus has noted, "[m]arkets work best when parties have more, not less, information." Amadeus Comments at 65 (Mar. 17, 2003). See also Sabre Comments, at 58 n.62 (Mar. 17, 2003).²⁴

Conclusion

Orbitz continues to be committed to the rulemaking initiatives that it recommended in its Comments. The consequences of twenty years of regulation on automated distribution cannot be eradicated with the stroke of a pen, but Orbitz believes that these transitional regulations will enable competition to be introduced into the CRS marketplace, and Part 255 to be sunset, within three years:

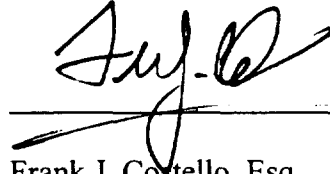
1. The continued prohibition of display bias by CRSs.
2. The repeal of the mandatory participation rule.

²⁴ Expedia cites a claim submitted to the Department in early 2002 by Sabre that small carriers consistently sell a higher percentage of their tickets through Expedia and Travelocity than through Orbitz. See Expedia Comments, at 12 (Mar. 17, 2003). However, Sabre purported to have submitted the underlying study to the Department under seal, despite never having filed a motion for confidential treatment. The data and methodology never has been made available for public scrutiny by the Department. Moreover, according to a study subsequently performed by Orbitz, small carriers in fact consistently sell more than their "fair share" of tickets through Orbitz. See Exhibit B.

3. The extension of the anti-parity rule to all airlines and the prohibition of other CRS contract clauses restricting airline choices on system usage.
4. The application of Part 255 to each CRS, whether or not it is owned by or affiliated with an airline or airlines.
5. Vendors that do not bind agent beyond each transaction should not be covered by the CRS rules.
6. Provisions enabling travel agents to have with freedom of choice among booking channels by limiting productivity pricing (and allowing agencies to renegotiate their contracts to provide for other means of compensation); limiting the terms of subscriber contracts (with no “shingling” allowed); limiting liquidated damages to the cost of physically removing a system from an agency; and allowing third-party software (including back-office software) to be used on all equipment, whether or not it is owned by the agency.
7. The sunset of Part 255 three years after the effective date of these changes, unless it affirmatively is demonstrated to the satisfaction of the Department that competition does not exist in the CRS marketplace.

* * * *

Respectfully submitted,

A handwritten signature in black ink, appearing to read "F. Costello", is written over a horizontal line.

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Dated: June 9, 2003

Exhibit A

**AN ANALYSIS OF
DISTRIBUTION COSTS
ORBITZ vs. SABRE-BASED
GDS TRAVEL AGENCY**

April 2003

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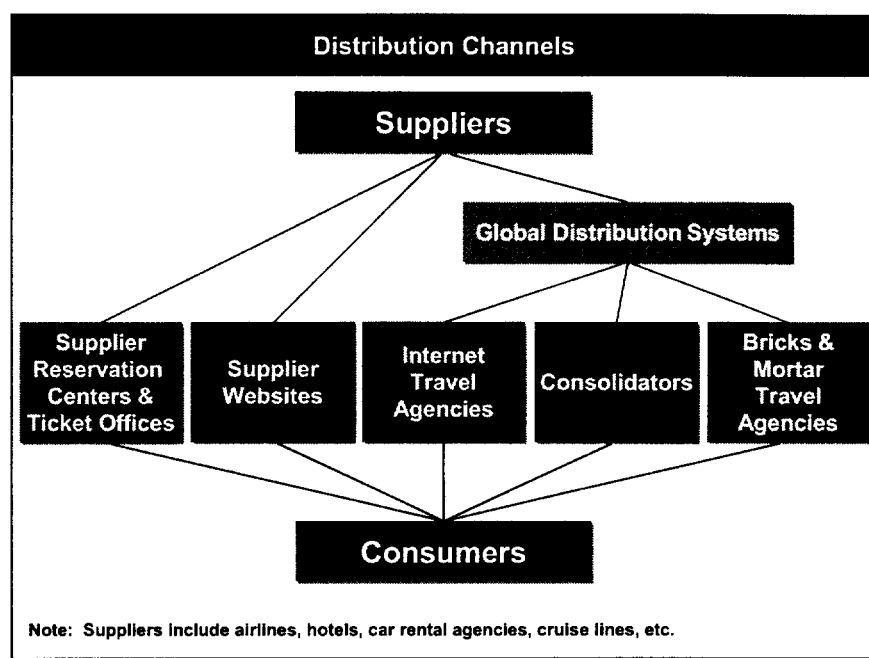
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BACKGROUND

Over the past five or so years, there has been increasingly intense pressure on air carriers to lower costs, in general. That pressure became particularly evident when, in 2001, the combination of a recession, "dot.com" bubble burst, and the events of 9/11 pushed the U.S. air carrier industry into a severe financial crisis. The situation today can best be described by the fact that the U.S. industry will generate roughly \$27 billion in losses in the three years, 2001-2003. Equally important, the industry debt to capital ratio has risen to about 93%, a clearly untenable position. In this context, we have seen US Airways, United Airlines, and Hawaiian Airlines file Chapter 11 bankruptcy. American Airlines has indicated that it will file Chapter 11 absent concession agreements from all of its unions. US Airways emerged from Chapter 11 reorganization at the end of March 2003. Several carriers, including Vanguard and National Airlines, have been forced into liquidation. The U.S. industry could be faced with further bankruptcies, depending on the length of the recovery from the Iraq conflict, the impact of SARS, and the effect of the general softness in the U.S. and world economies. In response to 9/11, the government provided roughly \$5 billion in impact assistance, and a further \$10 billion in government guaranteed loan availability to those carriers that qualified. In April 2003, the U.S. government approved an additional \$2.3 billion in direct assistance to cover the costs of security being incurred by the airlines.

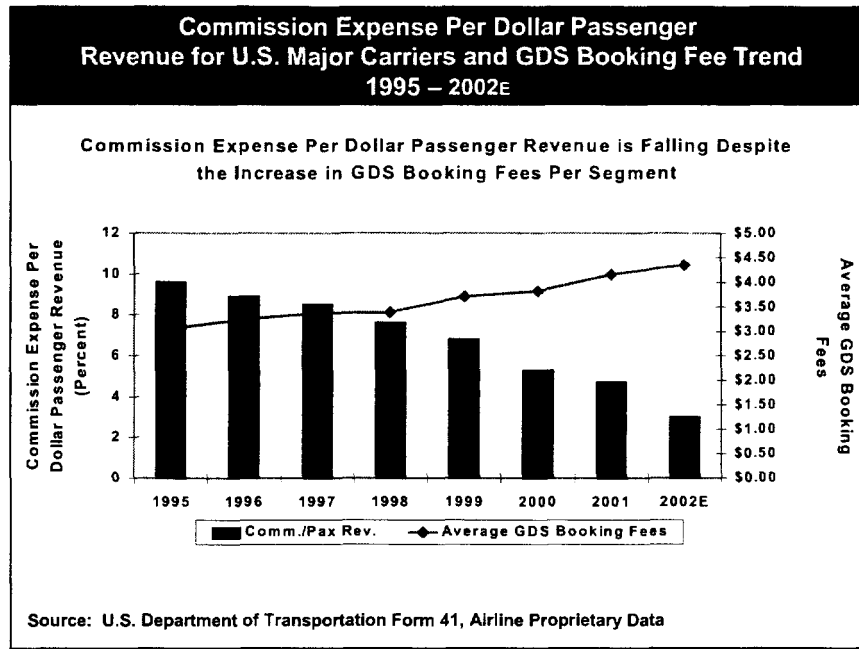
In the context of the economic environment of the late 1990s and into 2003, U.S. network carriers, in particular, have focused on all aspects of their cost structures. One major functional cost category that has concerned airlines for a number of years is the cost of "distribution." That is, beginning with the first contact between the consumer and his or her booking agent, through the ticketing, airport check-in, and back-office accounting process, costs had become substantial. In the late 1990s and early 2000s, these costs could represent 20% to 25% of an air carrier's cost structure. Consequently, it became an area of grave concern.

One of the major components of the cost of distribution was travel agency commissions, which reached a peak of almost 12% of passenger revenue in 1994. Another substantial cost component to the airlines, and thus ultimately to the consumer, are Global Distribution System (GDS) booking fees. These fees arise whenever a consumer buys an airline ticket through a travel agency, tour operator, wholesaler, or internet-based agency. The booking by the consumer, unless made directly with the supplier, e.g., air carrier, hotel or car rental company, is made by the intermediary agent on one of four major GDSs: Sabre, Galileo, Amadeus, and Worldspan.



The actual transaction reserves the seat and creates the ticket. This is accomplished by large legacy computer systems owned by the GDSs. The travel agency or other intermediary has made the sale, but the cost of the sale is billed to the supplier, in this instance the airline, hotel, car rental company, etc. In numerous studies of the cost structure of GDS booking fees over the past few years, we have found that while other distribution costs have been declining, either in an absolute sense or as a percent of revenue generated, booking fee

costs have been increasing. In a ga^2 study published in July 2002, "The Economics of Travel Distribution In an Internet Driven Environment," we found that between 1990 and 2000, GDS booking fees had escalated by roughly 7% per annum. With the introduction of the Internet and the increased availability of



online travel distribution through vehicles such as Orbitz, Priceline, Expedia, and others, the rate of increase in GDS booking fees began to subside. Clearly, this was a response to competitive pressures, although the GDSs still maintain measurable pricing power. Between 1995 and 2001, booking fees increased by 4.5% per annum, reaching an estimated annual average level of \$4.36 per segment in 2002 (which equates to \$12.20 per ticket, based on an average 2.8 segments per ticket).

Earnings during this time period were substantial for the GDSs. On the other hand, U.S. and world air carriers struggled to reach 5% profit margins during the late 1990s and fell to "zero" by 2001. In a New York Times article, Even as the Big Airlines Struggle, A Computer Booking System Prospers, dated February 10, 2003, the President of Sabre is asserted by the author to have observed that Sabre's fees are worth every penny. However, the article's author also observes,

“...the airlines have used their considerable lobbying power, persuading the Department of Transportation to propose eliminating some of the rules that help Sabre and its three rivals—Galileo, Worldspan and Amadeus—keep their fees up.” This raises the question, among others, “Why would the airlines use their leverage to change the rules if the booking fees were truly “worth every penny?” The airlines, among others, must believe the current regulations are supporting higher CRS costs than a deregulated, competitive market would achieve.

METHODOLOGY

This analysis of the cost of booking a transaction through a travel agency via Sabre or a typical GDS, compared to the costs and fees of a booking online through Orbitz, required that comparability of costs between the channels be defined and established at the outset.

As a starting point, we determined to use only those cost categories that were reasonably available, subject to definition, and where the source of information and data was credible and recognizable.

There are, as noted, numerous costs incurred by airlines related to the booking and ticketing of passengers, including those that are measurable and quantifiable. Others, while determinable through airlines' internal accounting systems, are unavailable to those outside the airline, e.g., back office accounting.

Thus, we are dealing here with the cost categories that we can define and measure with a high degree of reliability, including:

1. GDS booking fees charged to airlines
2. Rebates, volume, or offset discounts to GDS booking fees
3. Sales Commissions paid by air carriers to travel agencies
4. Service fees charged by “Brick & Mortar” agencies and by Orbitz, the online agency

The sources of these data sets include confidential and aggregated surveys of booking fees charged to airlines; sales commissions paid to travel agencies and ticket values, as reported by airlines to the U.S. Department of Transportation; the "2002 U.S. Travel Industry Survey" published by Travel Weekly Magazine; and Orbitz service fees, volume discounts to carriers, and transaction charges to carriers and consumers as supplied to us by Orbitz.

CURRENT FINDINGS

In one of many efforts to rationalize its fee structure, Sabre has developed a comparative analysis of booking fees for a round trip ticket generated by a travel agency on a GDS and a consumer direct booking on Orbitz. That study, "AIRLINE DISTRIBUTION COSTS PER TICKET", published by Sabre and until recently found on its website, stated that the booking fee and related commission and transactions costs of a ticket booked through a travel agent between November 2002 and June 2003 are estimated at \$9.98, while the same booking on Orbitz would cost the airline \$13.32.

Sabre, in its analysis of costs to airlines of a GDS booking through travel agencies on Sabre versus online, failed to include or mis-stated certain costs related to GDS and Orbitz bookings, including:

- No recognition of the travel agent commissions being paid by airlines. While these payments are now often characterized as "incentives" or "overrides," they are still commission payments to travel agencies.
- Overstatement of transaction fees paid by airlines to Orbitz.
- No recognition of the historical and expected booking fee escalation.

- No recognition of "Supplier Link," which allows bookings to take place through Orbitz, directly to the supplier, thus eliminating any booking fee by a GDS.
- Failure to recognize the differences in fees charged to the passenger by a travel agency, compared to the fees charged to the passenger by Orbitz.

A. BOOKING FEE COST TO AIRLINES

When these factors are fully recognized, the current round trip ticket distribution cost comparison is:

Orbitz-Average of all airlines	\$16.43
-Charter Associates only	\$16.22
-Supplier Link	\$9.58
vs.	
Sabre Travel Agency	\$26.20

Orbitz cost lower than Sabre Travel Agency:

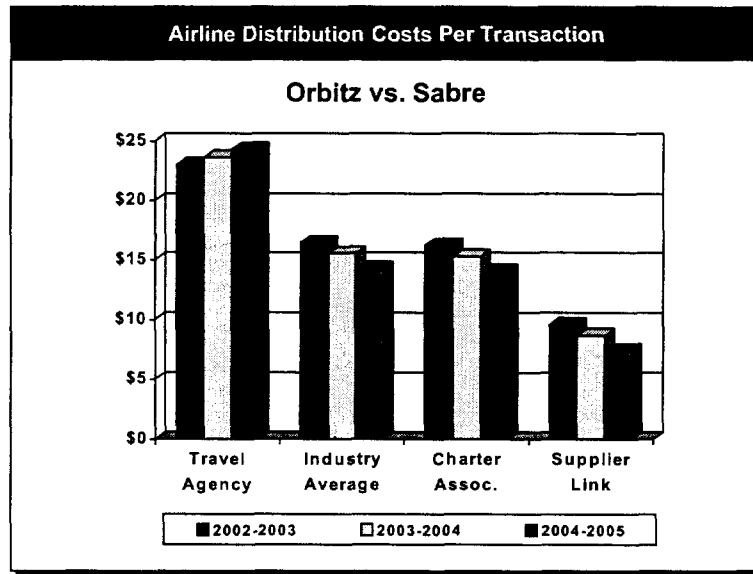
Orbitz Average of all airlines	37.3%
Orbitz Charter Associates only	38.1%
Orbitz Supplier Link	63.4%

The detailed costs, by year, may be found in Attachment A.

Airline Distribution Costs Per Transaction - Summary							
Orbitz vs. Sabre (June 2002 – May 2005)							
Cost Category	Travel Agency	ORBITZ			Percent Orbitz Total Cost Is Less Than Travel Agency:		
		Industry Average	Charter Assoc.	Supplier Link	Industry Average	Charter Assoc.	Supplier Link
Total Distribution Cost ('02-'03)	\$26.20	\$16.43	\$16.22	\$9.58	-37.3%	-38.1%	-63.4%
Total Distribution Cost ('03-'04)	\$26.82	\$15.52	\$15.31	\$8.67	-42.1%	-42.9%	-67.7%
Total Distribution Cost ('04-'05)	\$27.46	\$14.25	\$14.04	\$7.40	-48.1%	-48.9%	-73.1%

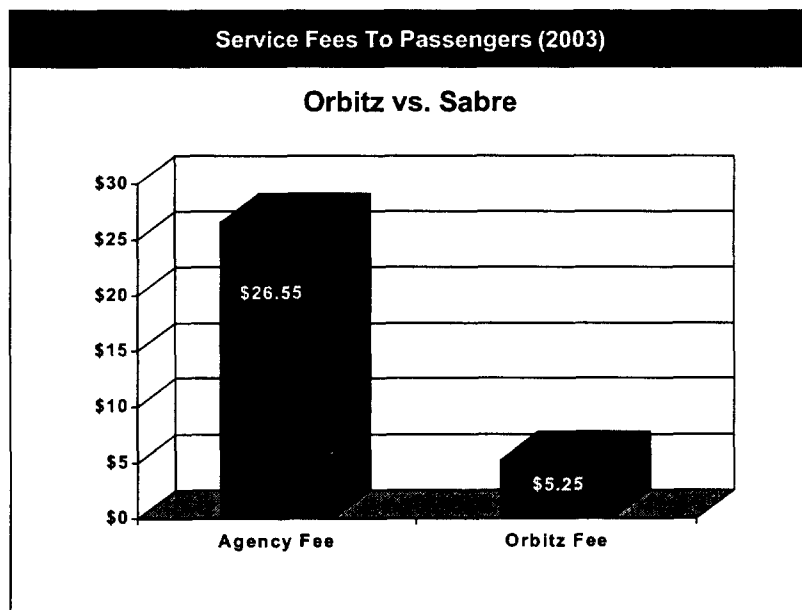
These disparities in distribution costs to airlines actually increase over the years as the transaction fees to Charter Associates of Orbitz decline. Thus, by July 2004, average Charter Associates' transaction costs through Orbitz will be roughly \$14.04 per ticket, while these costs would amount to \$27.46 through a travel agency. So the travel agency's costs would be \$13.42 (or about 96%) higher than a transaction through Orbitz.

These costs also do not include service fees charged by travel agencies, both "brick & mortar" and online, to the passenger.



B. SERVICE FEES TO THE CONSUMER (PASSENGER)

In addition to the costs incurred by airlines, and thus ultimately passed to the passenger in the ticket price, the booking that takes place via a travel agency through a GDS, or online through Orbitz, generates a “service charge” to the passenger.



This charge is generally called a “service fee.” As can be seen from the chart above, the service fee charged by the travel agency, as reported in the “2002 U.S. TRAVEL INDUSTRY SURVEY,” published by Travel Weekly Magazine, “brick & mortar” travel agencies charge passengers \$26.55 per ticket issued, on average. Orbitz also imposes a service fee for tickets booked online through its website, but it amounts to only \$5.25, on average, or an 80% discount from the fee typically charged by a traditional travel agency.

In summary, the cost of distributing a round trip airline ticket through Orbitz is measurably less costly, under any set of circumstances, than booking that ticket through a Sabre-based or other “brick and mortar” travel agency. The current industry average cost of a booking through Orbitz of \$21.68 (\$16.43 to the airline and \$5.25 to the passenger) compares very favorably with the cost of \$52.75 (\$26.20 to the airline and \$26.55 to the passenger) when the booking and ticketing takes place through a travel agency via a GDS. Moreover, when the transaction takes place through Orbitz on an airline with Supplier Link, the cost is reduced to \$14.83 (\$9.58 to the airline and \$5.25 to the passenger).

On average, the disparity in cost between the two forms of booking will continue to grow as more and more carriers move to Supplier Link and as the GDS booking fees continue to increase in future years, albeit at a somewhat more moderate rate of escalation.

Airline Ticket Distribution Costs Per Transaction Orbitz vs. Sabre (June 2002 - May 2003)

Cost Category	Travel Agency	Orbitz			Percent Orbitz Total Cost Is Less Than Travel Agency:		
		Industry Average	Charter Associates	Supplier Link	Industry Average	Charter Associates	Supplier Link
GDS Booking Fee ^{1/}	\$15.39	\$13.64	\$13.64	\$4.00	-11.3%	-11.3%	-74.0%
Less: Offset ^{2/}	\$0.00	(\$2.79)	(\$3.00)	\$0.00			
Net GDS Booking Fee	\$15.39	\$10.85	\$10.64	\$4.00	-29.5%	-30.8%	-74.0%
Commission/Transaction Fee ^{3/}	\$10.82	\$5.58	\$5.58	\$5.58	-48.4%	-48.4%	-48.4%
Distribution Cost to Airline	\$26.20	\$16.43	\$16.22	\$9.58	-37.3%	-38.1%	-63.4%
Agency Fee to Passenger ^{4/}	26.55	5.25	5.25	5.25	-80.2%	-80.2%	-80.2%
Total Booking/Ticketing Fees	\$52.75	\$21.68	\$21.47	\$14.83	-58.9%	-59.3%	-71.9%

1/ Assumes \$4.00 Supplier Link Booking Fee (provided by Orbitz), Charter and Industry Average Booking Fee of \$13.64 (\$4.40 per segment times 3.1 average segments per Orbitz transaction), and Travel Agents/Sabre Booking Fee 12.8% higher (from Sabre presentation) than Worldspan Booking Fee during Nov. 2002-June 2003 period and then increased by 4% in each subsequent period, based on recent GDS booking fee rate escalation history.

2/ \$3.00 Offset/Rebate for Charter members who account for 93% of all Orbitz members. Industry Average Offset/Rebate of \$2.79 reflects that ratio.

3/ 75% of Orbitz issued tickets cost more than \$150.00, thus the average commission is \$5.58 during Nov. 2002-June 2003 period, \$4.67 during the July 2003-June 2004 period, and \$3.40 during the July 2004-June 2005 period. For Travel Agents/Sabre, the average commission is \$10.82 (an average commission rate of 3.0% times the average systemwide round trip fare of \$360.58).
Source: Department of Transportation OD1A and Form 41 databases, both reflecting the 2nd Quarter 2002.

4/ Rates are for 2002-2003 and assume no escalation.

Airline Ticket Distribution Costs Per Transaction Orbitz vs. Sabre (June 2003 - May 2004)

Cost Category	Travel Agency	Orbitz			Percent Orbitz Total Cost Is Less Than Travel Agency:		
		Industry Average	Charter Associates	Supplier Link	Industry Average	Charter Associates	Supplier Link
GDS Booking Fee ^{1/}	\$16.00	\$13.64	\$13.64	\$4.00	-14.8%	-14.8%	-75.0%
Less: Offset ^{2/}	\$0.00	(\$2.79)	(\$3.00)	\$0.00			
Net GDS Booking Fee	\$16.00	\$10.85	\$10.64	\$4.00	-32.2%	-33.5%	-75.0%
Commission/Transaction Fee ^{3/}	\$10.82	\$4.67	\$4.67	\$4.67	-56.8%	-56.8%	-56.8%
Distribution Cost to Airline	\$26.82	\$15.52	\$15.31	\$8.67	-42.1%	-42.9%	-67.7%
Agency Fee to Passenger ^{4/}	26.55	5.25	5.25	5.25	-80.2%	-80.2%	-80.2%
Total Booking/Ticketing Fees	\$53.37	\$20.77	\$20.56	\$13.92	-61.1%	-61.5%	-73.9%

1/ Assumes \$4.00 Supplier Link Booking Fee (provided by Orbitz), Charter and Industry Average Booking Fee of \$13.64 (\$4.40 per segment times 3.1 average segments per Orbitz transaction), and Travel Agents/Sabre Booking Fee 12.8% higher (from Sabre presentation) than Worldspan Booking Fee during Nov. 2002-June 2003 period and then increased by 4% in each subsequent period, based on recent GDS booking fee rate escalation history.

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Airline Ticket Distribution Costs Per Transaction Orbitz vs. Sabre (June 2004 - May 2005)

Cost Category	Travel Agency	Orbitz			Percent Orbitz Total Cost Is Less Than Travel Agency:		
		Industry Average	Charter Associates	Supplier Link	Industry Average	Charter Associates	Supplier Link
GDS Booking Fee ^{1/}	\$16.64	\$13.64	\$13.64	\$4.00	-18.0%	-18.0%	-76.0%
Less: Offset ^{2/}	\$0.00	(\$2.79)	(\$3.00)	\$0.00			
Net GDS Booking Fee	\$16.64	\$10.85	\$10.64	\$4.00	-34.8%	-36.1%	-76.0%
Commission/Transaction Fee ^{3/}	\$10.82	\$3.40	\$3.40	\$3.40	-68.6%	-68.6%	-68.6%
Distribution Cost to Airline	\$27.46	\$14.25	\$14.04	\$7.40	-48.1%	-48.9%	-73.1%
Agency Fee to Passenger ^{4/}	26.55	5.25	5.25	5.25	-80.2%	-80.2%	-80.2%
Total Booking/Ticketing Fees	\$54.01	\$19.50	\$19.29	\$12.65	-63.9%	-64.3%	-76.6%

1/ Assumes \$4.00 Supplier Link Booking Fee (provided by Orbitz), Charter and Industry Average Booking Fee of \$13.64 (\$4.40 per segment times 3.1 average segments per Orbitz transaction), and Travel Agents/Sabre Booking Fee 12.8% higher (from Sabre presentation) than Worldspan Booking Fee during Nov. 2002-June 2003 period and then increased by 4% in each subsequent period, based on recent GDS booking fee rate escalation history.

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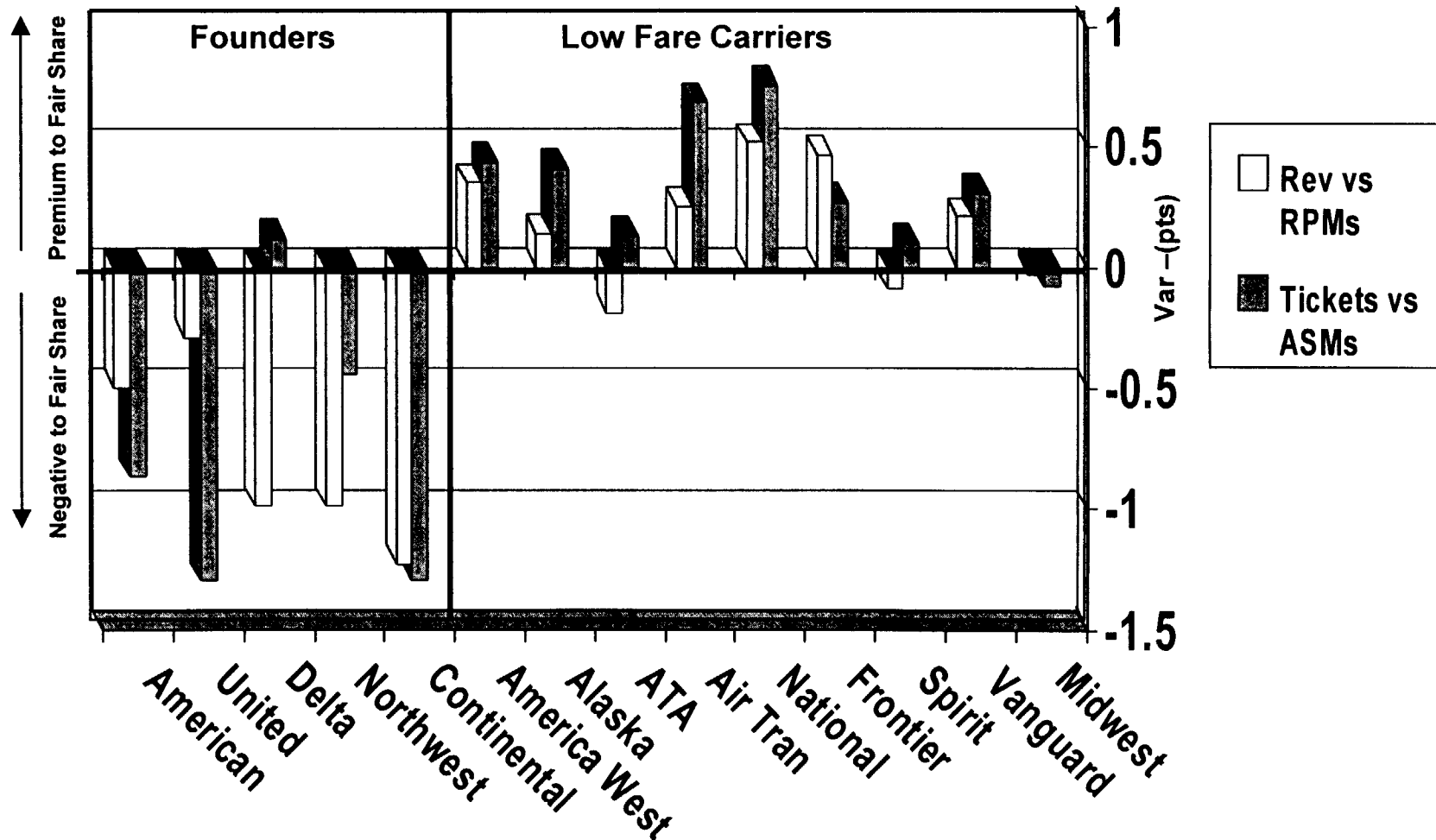
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Total Distribution Cost ('04-'05)	\$54.01	\$19.50	\$19.29	\$12.65	-48.1%	-48.9%	-73.1%

Exhibit B

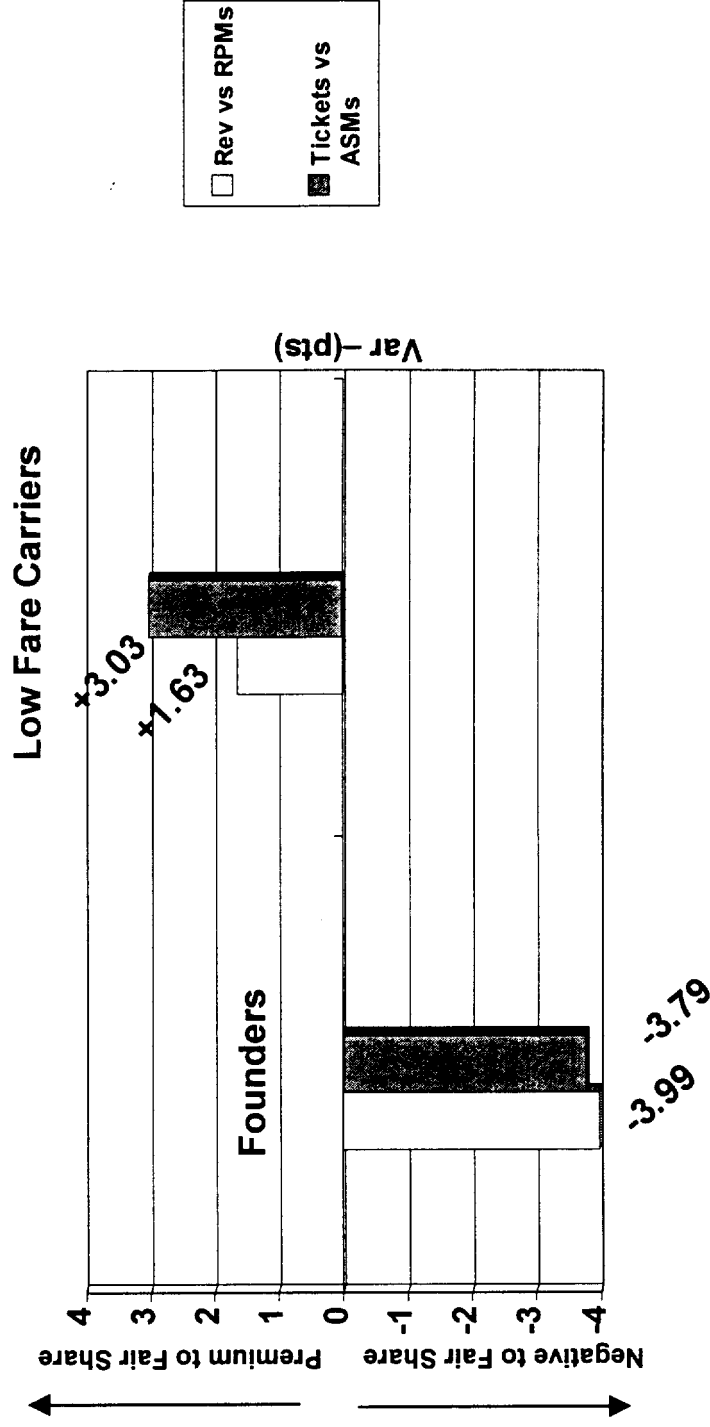
Founders vs. Low Fare



Jan. 1 to July 21, 2002. RPM and ASM data from ECLAT Consulting

CRBITZ

Founders vs. Low Fare



Jan. 1 to July 21, 2002. RPM and ASM data from ECLAT Consulting

CABITZ

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of June 2003, a copy of the foregoing Reply Comments of Orbitz, Inc. was served by first class mail, postage prepaid, by e-mail, or by hand, on the following.



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